12

(3)

No. 07-164

FILED
NOV 9 - 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

In The

Supreme Court of the United States

KINDER MORGAN CO_2 COMPANY, L.P.,

Petitioner,

v.

RUSSELL GARY HEIMANN, PECOS SLOPE ROYALTY TRUST AND RIO PETRO LTD., INDIVIDUALLY AND ON BEHALF OF ALL OTHER PRIVATE ROYALTY AND OVERRIDING ROYALTY OWNERS IN THE BRAVO DOME CARBON DIOXIDE UNIT, NEW MEXICO, SIMILARLY SITUATED,

Respondents.

On Petition For A Writ Of Certiorari To The Court Of Appeals Of New Mexico

PETITIONER'S REPLY BRIEF

JOHN B. POUND
LONG, POUND & KOMER, P.A.
2200 Brothers Road
P.O. Box 5098
Santa Fe, NM 87502-5098
(505) 982-8405

GUY S. LIPE
Counsel of Record
VINSON & ELKINS L.L.P.
2500 First City Tower
1001 Fannin
Houston, TX 77002-6760
(713) 758-1109

Counsel for Petitioner Kinder Morgan CO_2 Company, L.P.

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

I. The Split in the Circuits Regarding Application of the Presumption in Favor of Arbitration to Narrow Arbitration Clauses is Substantive and Substantial ... 1

II. The New Mexico Court of Appeals Utilized a Restrictive Approach to the Application of the Presumption Favoring Arbitration, Both With Regard to Plaintiffs' Contract Claims and Non-Contract Claims 2

A. The Contract Claims 3

B. The Non-Contract Claims 7

III. The Non-Contract Claims Remain in the Case 9

IV. Plaintiffs Make Numerous Misstatements in Their Response Brief 10

CONCLUSION 14

TABLE OF AUTHORITIES

Page

CASES

Choice Hotels Intern. Inc. v. BSR Tropicana Resort, Inc., 252 F.3d 707 (4th Cir. 2001) 5, 6

Cummings v. FedEx Ground, 404 F.3d 1258 (10th Cir. 2005) 1, 8

In re Oil Spill by Amoco Cadiz, 659 F.2d 789 (7th Cir. 1981) 7

Intern. Brotherhood of Elec. Workers, Local 2188 v. Western Electric Co., Inc., 661 F.2d 514 (5th Cir. 1981) 2

Ivax Corp. v. B. Braun of Am., Inc., 286 F.3d 1309 (11th Cir. 2002) 2

J.J. Ryan & Sons, Inc. v. Rhone Poulenc Textile, S.A., 863 F.2d 315 (4th Cir. 1988) 7

Local 827, Intern. Broth. Of Elec. Workers, AFL-CIO v. Verizon New Jersey, Inc., 458 F.3d 305 (3d Cir. 2006) 1

Louis Dreyfus Negoce S.A. v. Blystad Shipping and Trading Inc., 252 F.3d 218 (2d Cir. 2001) 1

McMillan v. Allstate Indem. Co., 135 N.M. 17, 84 P.3d 65 (2004) 3

Trap Rock Industries Inc. v. Local 825, Intern. Union of Operating Engineers, AFL-CIO, 982 F.3d 884 (3d Cir. 1992) 1

TABLE OF AUTHORITIES – Continued

Page

Twin City Monorail, Inc. v. Robbins & Myers, Inc., 728 F.2d 1069 (8th Cir. 1984)..... 1

Washington Mailers Union No. 29 v. Washington Post Co., 233 F.3d 587 (D.C. Cir. 2000)..... 2

PETITIONER'S REPLY BRIEF

I. The Split in the Circuits Regarding Application of the Presumption in Favor of Arbitration to Narrow Arbitration Clauses is Substantive and Substantial.

Plaintiffs argue that "[w]hile different courts may articulate the standard to determine arbitrability [under narrow clauses] differently, they all apply the same standard substantively," and that a review of the decisions "indicates that the differences in language are semantic differences that do not affect the substantive analysis all courts apply." Response Brief 4, 31. The decisions cited in the Petition demonstrate that Plaintiffs are wrong and that the circuit split is substantive and substantial.

The Third Circuit holds that the presumption in favor of arbitration is "inapposite" to narrow arbitration clauses.[1] The Second, Eighth, and Tenth Circuits hold that a claim is arbitrable under a narrow clause only if it "is on its face within the purview of the clause."[2] The Fifth, Eleventh, and D.C. Circuits hold

---

[1] *Trap Rock Industries Inc. v. Local 825, Intern. Union of Operating Engineers, AFL-CIO*, 982 F.3d 884, 888 n.5 (3d Cir. 1992); Local 827, *Intern. Broth. Of Elec. Workers, AFL-CIO v. Verizon New Jersey, Inc.*, 458 F.3d 305, 310-311 (3d Cir. 2006).

[2] *Louis Dreyfus Negoce S.A. v. Blystad Shipping and Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001); *Twin City Monorail, Inc. v. Robbins & Myers, Inc.*, 728 F.2d 1069, 1072-1073 & nn.3, 4 (8th Cir. 1984); *Cummings v. FedEx Ground*, 404 F.3d 1258, 1262 (10th Cir. 2005).

that the presumption in favor of arbitration is fully applicable to both narrow and broad clauses.[3] As shown in the Petition, the state courts also are divided on the proper standard to be applied in determining arbitrability. There is no basis for Plaintiffs' contention that the differences in approach exhibited by these decisions are not substantive and involve only "semantics." The standard for determining whether claims relating to a contract containing a narrow arbitration clause are resolved in court or arbitration varies depending on where the case is filed.

II. The New Mexico Court of Appeals Utilized a Restrictive Approach to the Application of the Presumption Favoring Arbitration, Both With Regard to Plaintiffs' Contract Claims and Non-Contract Claims.

Plaintiffs claim that the conflict in the circuits on the application of the presumption favoring arbitration to narrow arbitration clauses is a "false issue because the New Mexico Court of Appeals did not apply the more restrictive test" for application of that presumption. Response Brief 4. That assertion is

---

[3] *Intern. Brotherhood of Elec. Workers, Local 2188 v. Western Electric Co., Inc.*, 661 F.2d 514, 516 n.3 (5th Cir. 1981); *Ivax Corp. v. B. Braun of Am., Inc.*, 286 F.3d 1309, 1320 n.23 (11th Cir. 2002); *Washington Mailers Union No. 29 v. Washington Post Co.*, 233 F.3d 587, 592 n.4 (D.C. Cir. 2000).

demonstrably false, both with regard to Plaintiffs' contract claims and Plaintiffs' non-contract claims.

A. The Contract Claims

In discussing the presumption favoring arbitration, the New Mexico court of appeals cited a prior New Mexico case holding that "the arbitration agreement will be given broad interpretation *unless the parties themselves limit arbitration to specific areas or matters.*" App. 8 (quoting *McMillan v. Allstate Indem. Co.*, 135 N.M. 17, 84 P.3d 65 (2004) (emphasis added)). Noting that "the language in the settlement agreement emphasizes the narrow scope of the arbitration clause," the court then held that rules of contract construction governed the interpretation of the exclusionary clause relating to claims for breach of the settlement agreement, making no further reference to the presumption favoring arbitration in determining whether Plaintiffs' contract claims were arbitrable. App. 9, 12-13. The court broadly interpreted the exclusionary clause to preclude arbitration of any claim in which Plaintiffs characterized Kinder Morgan's conduct as a breach of the settlement agreement, "regardless of whether they may involve prices of non-qualified contracts," and without any analysis of whether that broad interpretation of the exclusionary

clause precluded arbitration of the very type of claims that the arbitration clause was designed to cover.[4] *Id.*

Kinder Morgan argued that the exclusion from arbitration for "future claims for breach of this agreement" was intended to preclude arbitration of claims based on the deduction of Non-Qualified charges of the type that the agreement expressly prohibited, and that the exclusion did not exclude from arbitration claims based on the royalty payments resulting from the use of Non-Qualified prices and charges on which the parties "omit[ted] any agreement" in Section 14(c) of the settlement agreement. The New Mexico court of appeals never addressed that narrower interpretation of the exclusionary clause. The court inexplicably stated that Kinder Morgan's position "would leave essentially no viable claims that would not be subject to arbitration,"[5] but the court did not address Kinder Morgan's argument that the exclusion from arbitration would and should preclude arbitration if Kinder Morgan violated one of the provisions that prohibited certain types of Non-Qualified deductions, such as those found in Sections 9.2, 10, 11.2, and 11.4.[6] Nor did the court consider Kinder Morgan's argument that a claim challenging royalty payments that used Non-Qualified prices and charges on which the parties

---

[4] The court of appeals never explained what would remain arbitrable under its broad interpretation of the exclusionary clause.

[5] See App. 6.

[6] See App. 88-96.

"omit[ted] any agreement" under Section 14(c) cannot constitute a "future claim for breach of this agreement" for purposes of the exclusionary clause in Section 16 of the settlement agreement.

Contrary to the New Mexico court of appeals' approach, the proper application of the presumption favoring arbitration to the interpretation of an exclusionary clause is illustrated by the Fourth Circuit's decision in *Choice Hotels Intern. Inc. v. BSR Tropicana Resort, Inc.*, 252 F.3d 707 (4th Cir. 2001). In that case, the court interpreted an exclusionary clause that excluded from arbitration "actions for the collection of money owed . . . under this agreement." *Id.* at 710. The court rejected the plaintiffs' proposed interpretation of the exclusionary clause as covering all contract claims seeking money damages, instead holding that the exclusionary clause was limited to "traditional collection actions." *Id.* at 711. Noting that the plaintiff's broad interpretation of the exclusion would leave little subject to arbitration, the court held that the presumption favoring arbitration required a "narrow reading of the . . . exemption and a corresponding expansive construction of the general arbitration requirement." *Id.*

The New Mexico court of appeals conducted no such analysis. In their effort to avoid the conflict between the New Mexico court's approach and that of the Fourth Circuit in *Choice Hotels*, Plaintiffs argue that the arbitration clause in *Choice Hotels* was broad, while the clause in this case is narrow. Response Brief 32. That asserted justification

constitutes an acknowledgement by Plaintiffs that the New Mexico court applied a more restrictive approach in applying the presumption favoring arbitration to narrow clauses than broad clauses, contrary to Plaintiffs' other arguments in their Response Brief. In any event, the clause in *Choice Hotels* did not cover all disputes between the parties, but carved out three different categories of claims from arbitration. *Id.* at 709-710. The Fourth Circuit nevertheless held that the presumption favoring arbitration required a narrow interpretation of the exclusionary clause which would not eviscerate the right to arbitration created by the arbitration clause. *Id.* at 711.

Plaintiffs' second argument regarding *Choice Hotels* is that "New Mexico courts are not bound by Fourth Circuit precedent." Response Brief 32. In essence, Plaintiffs' argument is that the New Mexico state courts are permitted to issue decisions that are in conflict with the decisions of federal circuit courts of appeals in the United States. It is precisely that type of conflict that S. Ct. R. 10(b) addresses as a reason considered by this Court in granting certiorari.

The New Mexico court also improperly denied arbitration based on the Plaintiffs' unilateral characterization of their claims. While Plaintiffs attempt to create the impression in their Response Brief that the court of appeals went behind the legal labels that the Plaintiffs assigned to their claims, the opposite is true. With regard to both Count III and Count IV of

the complaint, the court simply held that because the Plaintiffs alleged that Kinder Morgan's conduct constituted a breach of the settlement agreement, the claims were not subject to arbitration. See App. 12-13 ("As stated in the complaint and on appeal, Plaintiffs' third claim alleges breach of the settlement agreement. It, therefore, is not subject to arbitration. . . . Plaintiffs thus allege breach of the settlement agreement in their fourth claim. This claim, as stated in Plaintiffs' complaint, is not subject to arbitration.") By holding that Plaintiffs' characterization of their claims was controlling, the court of appeals adopted a rule that conflicts with federal court of appeals decisions cited in the Petition at pages 25-26.[7]

B. The Non-Contract Claims

The New Mexico court of appeals also took a restrictive approach to application of the presumption favoring arbitration in denying arbitration of the non-contract claims. The court concluded that it was "not clear whether Plaintiffs challenge the prices under non-qualified contracts" in their non-contract claims, and it held that "based on the lack of clarity in Plaintiffs' complaint and subsequent statements," the district court did not commit error in refusing to compel arbitration. App. 18. The court of appeals thus

---

[7] *In re Oil Spill by Amoco Cadiz*, 659 F.2d 789, 794 (7th Cir. 1981); *J.J. Ryan & Sons, Inc. v. Rhone Poulenc Textile, S.A.*, 863 F.2d 315, 319 (4th Cir. 1988).

resolved doubts in favor of court litigation rather than arbitration. In support of that holding, the court of appeals cited the Tenth Circuit's decision in *Cummings v. FedEx Ground*, 404 F.3d at 1262, which applied a restrictive approach to the presumption favoring arbitration, and the New Mexico court said that "*given the narrow scope of the arbitration agreement in this case*, it is inappropriate to compel arbitration when Plaintiffs *may* not dispute the prices under non-qualified prices at all." App. 18 (emphasis added).

Thus, the court of appeals refused to resolve doubts concerning the arbitrability of Plaintiffs' non-contract claims in favor of arbitration, based on the narrow scope of the arbitration agreement. The court's decision directly implicates the circuit split concerning the proper application of the presumption favoring arbitration in the context of narrow arbitration clauses and it adopts a rule that encourages vague and artful pleading.[8]

---

[8] Plaintiffs argue that there is no evidence that they engaged in artful pleading. That argument misses the point. Regardless of the subjective motivation for Plaintiffs' vague pleadings, the rule adopted by the New Mexico court permits plaintiffs to avoid arbitration by pleading in vague terms or artfully pleading their case to circumvent the arbitration agreement. By resolving doubts in favor of arbitration, courts obviate the necessity for a subjective analysis into a plaintiffs' motivation. None of the cases cited in the Petition requiring that doubts resulting from vague pleadings be resolved in favor of

(Continued on following page)

III. The Non-Contract Claims Remain in the Case

Plaintiffs assert in their Response Brief that the issues presented in the Petition relating to the non-contract claims are not live issues because the trial court entered an order denying class certification of the non-contract claims. Response Brief 18. The fact that the Plaintiffs withdrew their request for class certification of the non-contract claims, resulting in an order denying class certification of those claims, does not take those claims out of the case. Plaintiffs' withdrawal of their request for class certification of non-contract claims means that those claims are asserted by the Plaintiffs only their individual capacities, and not on behalf of the class. The non-contract claims remain in the case as individual claims, and the issues presented in the Petition relating to those claims are worthy of review.[9]

---

arbitration (see Petition at 22) require any inquiry into a plaintiff's subjective motivations.

[9] Plaintiffs' Response Brief implies that the limitation of class certification to the contract claims is a recent event. Response Brief 18. In fact, as the class certification order states on its face, Plaintiffs withdrew their request for certification of the non-contract claims in February 2005 (Resp. App. 57), yet the parties appropriately have continued to litigate in the trial court and on appeal the arbitrability of the non-contract claims, as those claims remain in the case, asserted by the named plaintiffs in their individual capacities.

IV. Plaintiffs Make Numerous Misstatements in Their Response Brief.

In their Response Brief, Plaintiffs accuse Kinder Morgan of making misstatements to this Court. Those accusations are unfounded.[10] Actually, Plaintiffs' Response Brief contains numerous statements, designed to suggest that this case does not present issues worthy of this Court's review, which are inaccurate, incomplete, or directly contrary to the true facts. The following examples are particularly noteworthy:

1. Plaintiffs argue that the court of appeals' decision is correct because the arbitration clause applies only if Kinder Morgan gives advance notice to all class members of its intent to use Non-Qualified prices in its royalty calculations and if the parties are unable to reach agreement concerning such use. Response Brief 24. Plaintiffs fail to inform this Court that the court of appeals expressly rejected that interpretation of the settlement agreement, stating that the Plaintiffs' interpretation was unreasonable because "it allows arbitration only when Kinder

[10] For example, at page 13 of their Response Brief, Plaintiffs accuse Kinder Morgan of making statements at page 6 of the Petition that purportedly are inaccurate. Response Brief 13. The statements described on page 13 of the Response Brief are not made anywhere in the Petition.

Morgan has followed specific procedures that do not appear within the settlement agreement." App. 6-7.[11]

2. Plaintiffs argue that their contract claims do not include claims regarding the use of Non-Qualified prices, stating that they "cannot explain why the Court of Appeals" characterized the contract claims as challenging the use of Non-Qualified prices in the royalty calculations." Response Brief 29. They also suggest that the court of appeals contradicted itself on this issue by virtue of a statement at App. 18 that "Plaintiffs may not dispute the prices under non-qualified contracts at all." *Id.* That latter statement by the court of appeals related to the *non-contract* claims, not the contract claims as suggested by Plaintiffs in their Response Brief. App. 17-18. Additionally,

---

[11] Plaintiffs assert that the unit operator, OXY USA, Inc. ("Oxy"), responded to the same claims by arguing that the claims were not arbitrable, and Plaintiffs assert, outside the record in this case, that the claims against Oxy were settled in 2005, prior to a jury trial. Response Brief 5 n.2. Plaintiffs fail to disclose to this Court other facts outside the record in this case but which are a matter of public record in Plaintiffs' lawsuit against Oxy, *i.e.*, that Plaintiffs took the position in their lawsuit against Oxy that "[n]ot a single Non-Qualified contract plays a part in Oxy's valuation method," unlike Kinder Morgan's valuation methodology, and that Oxy did in fact file a motion to compel arbitration after discovery was completed, with Plaintiffs arguing that Oxy waived its arbitration rights by filing a lawsuit. "Plaintiffs' Memorandum in Response to Defendant's Motion for Partial Summary Judgment on Breach Claims and to Compel Arbitration" filed August 23, 2005 in *Heimann v. OXY USA, Inc.*, Case No. 04-24-CV, in the District Court of Union County, New Mexico, at 2, 6.

a supplemental brief and supporting affidavit that Plaintiffs filed the day before the hearing on the motion to compel arbitration (reproduced in the Appendix attached to the Response Brief) demonstrate definitively that Plaintiffs *are* challenging Kinder Morgan's use of Non-Qualified prices in the royalty calculations, as noted by the court of appeals and contrary to Plaintiffs' statements in their Response Brief.[12]

3. Plaintiffs assert that "most of the CO_2 upon which Kinder Morgan is obligated to pay royalty is not bought or sold but is delivered in-kind for Kinder Morgan's own use." Response Brief 6-7. That statement is false. The evidence attached to the motion to compel arbitration demonstrated that the Bravo Dome CO_2 is sold under contracts to other parties, copies of which have been produced to Plaintiffs in discovery.

4. Plaintiffs assert that the motion to compel arbitration was filed two months after the complaint was filed, implying that the motion was an afterthought. Response Brief 7. In fact, Kinder Morgan's

---

[12] In the supplemental brief, Plaintiffs complained that "Kinder-Morgan has used CO_2 prices from non-approved, Non-Qualified Contracts mixed with approved contract prices to determine and pay royalty" and that the parties "did not agree to the use of Non-Qualified Contracts in the agreed methodology for calculating settlement royalty values." Resp. App. 10, 13. Plaintiffs' supporting expert affidavit repeatedly challenged the propriety of Kinder Morgan's use of Non-Qualified prices in the royalty calculations. See Resp. App. 37-39.

first pleading, its answer, raised the arbitration argument which was also presented by motion promptly after challenges to judges initially assigned to the case were resolved and the actual trial judge was appointed.

5. Plaintiffs filed a brief in the trial court that said that the case "involves a search for truth behind the Non-Qualified Contracts." App. 80. In an effort to avoid the impact of that concession on the arbitrability issue, Plaintiffs assert that their statement was based on a lack of information. Response Brief 33. There was no such lack of information. As Plaintiffs' supplemental brief and supporting affidavit filed the day before the hearing on the arbitration motion make clear, Plaintiffs challenge the method of royalty calculation that was described in the affidavit of Kinder Morgan's expert filed with Kinder Morgan's motion to compel arbitration, long before Plaintiffs characterized their case as a "search for truth behind the Non-Qualified Contracts." Resp. App. 10, 11, 13, 37-39. Plaintiffs' disingenuous explanation of its statements in prior briefing is part of Plaintiffs' effort to avoid arbitration of the very type of claims that the parties agreed to arbitrate.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

GUY S. LIPE
Counsel of Record
VINSON & ELKINS L.L.P.
2500 First City Tower
1001 Fannin
Houston, TX 77002-6760
(713) 758-1109
Counsel for Petitioner Kinder Morgan CO_2 Company, L.P.

JOHN B. POUND
LONG, POUND & KOMER, P.A.
2200 Brothers Road
P.O. Box 5098
Santa Fe, NM 87502-5098
(505) 982-8405